the technical analyst AWARDS 2011 FINALIST

15th February 2018

Market Update:

UPDATE
Technical
Fundamental

The particular threat to the UK bond market

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The particular threat to the UK bond market

WEEKLY EFT CHART

The triple failure at the 50% retracement at the 58.5 level set the tone for the market over the year so far.

Now attention is focusing on the Support from the Prior High at 56 **and the possible breakdown beneath the Prior Low at 55.5.**

A break of both would set the bear seal on both the long and medium-term market.

The market <u>did</u> close beneath 56.0 but <u>not</u> beneath that 55.5 low this week.

What is the scope for retracement?

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DAILY Gilt future CHART

The day chart is being driven by the parallel Flag that completed in early January.

The next key short-term bear trigger was at the end of the month when the market broke beneath the Prior Low at 122.5 from the end of November 2017.

Note the rally on Friday last: the first resistance lies above the market at 122.5.

<u>Unless that resistance can be overcome the market remains bearish.</u>

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More

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FUNDAMENTALS:

The long Bull market in government bonds driven by the era of globalisation and very low inflation, seems to be drawing to a close.

As the emerging market economies developed, especially China, the developed world was able to enjoy a period of solid expansion with exceptionally low inflation as they outsourced production to these very low-cost manufacturing centres, but all good things eventually come to an end.

China is now the world’s second largest economy and still expanding and labour costs are no longer so cheap. In fact, the authorities there are concerned about the their negative demographics, which led them to abandon their One Child policy.

There are other factors that are also working against the environment that has for so long fostered exceptionally low Bond yields.

- In the US, Trump’s election as President has seen the US challenge the established world order it had established after WW11 with his America first policy which is essentially protectionism.

- In the UK, the country has voted to leave the EU, an institution with a massive single market that the UK has belonged to for 40 odd years. The exit negotiations between the UK and EU have not been easy. The negotiations to establish a new trading relationship are looking no easier and judging by some recent comments coming from the EU look like being more difficult yet. In fact, one might think the two were long-standing enemies rather than close trading partners.

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FUNDAMENTALS: CONTINUED

For the Gilt, the prospect of economic dislocation goes deeper. The decision to leave the EU may turn out to be a positive move long term, it is far too soon to know. But short/medium term it has caused the UK economy to go from the strongest best performing in the Group of 7 developed economies to being the weakest, with stubbornly high inflation.

Add in the threat to the City of London which has enjoyed a position as the World's pre-eminent financial Centre, contributing significantly to UK GDP and providing the UK Government with a hefty chunk of its tax revenue and traders/investors are concerned about the outlook for the UK's fiscal health if the new trading arrangements do not include services and the City, something the EU side is actively seeking.

Then there is domestic monetary policy. The Bank of England now judges the UK economy's growth potential has dropped from about 2.3% to not much above 1.5%. As a result, the current rate of growth which is about 1.5% is not seen as a barrier to the Bank raising interest rates as it seeks to bring CPI down from its current level of 3.0% to its target of 2.0% in two years time.

Clearly much of the UK's current difficulties are caused by the uncertainty of Brexit which has seen Sterling suffer a steep devaluation, pushing up inflation, driving real wages into negative territory and causing businesses to delay or abandon investment decisions.

Consider all of this against the backdrop of negative international sentiment towards government bonds since Trump's tax cut agenda was voted into law in the US adding at least one Trillion Dollars to the US budget deficit, driving up US bond yields in expectation of rising US inflation and the international environment for bonds has turned negative. Especially the UK Gilt.

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SEVEN DAYS AHEAD
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